

CHAPTER 1

INTRODUCTION

1.1 Background of Study

A firm was built to give prosperity to the firm's owner or shareholder. This goal could be realized by maximize the value of the company with the assumption that firm's owner or stake holder will gain the prosperity if firm's wealth increased.

Increased wealth of a firm could be measured by the increasing of the stock's price or the increasing of firm's value (Susanti, 2014).

Finance condition of a firm could be seen through its finance statement.

Finance statement is a tool to communicate the main financial information to whom they needed. The financial statements show the results of the company's operations in monetary value. Financial statements that frequently presented are the balance sheet, income statement, cash flow statement and owner's equity or shareholders statement. In addition, notes to financial statements or disclosures are also an integral part of every financial report (Kieso, 2008).

There are 4 important variables in analyze a company's financial statement and performance, which consist of profitability, efficiency, solvency, and market prospect. The 4 variables mentioned above have the ability to help future investors, investor, creditors and inner management make an analysis at a company's performance and it's future potential if the operation were managed properly. In this aspect, profitability can be determined as the capability of a firm to make use of their resources to bring in more profits than its expenses.

Revenues and expenses of a company are the key aspects of profitability.

Revenues are the income that a company get from selling or providing goods / services for customers. Cash, land, and etc which are considered as company usually use the resources to pay employee wages, building or factory rent fee, and other production cost in production process. Relationship of revenues and expenses could detect the overall performance of a company and their potential growth.

Every company has a main ultimate purpose which is to make profit. A company that doesn't have investors or stable finance, profit might be the only capital they have. Insufficient capital or financial resources will lead to a business failure because a company need them to sustain and run the company. A company couldn't survive if they couldn't make sufficient profit in a certain time.

Both profitability and liquidity are important existence in continuous survival of a company. Profitability help a business or company to measure and understand their past financial performance, while liquidity enable the company to understand its current position and situation of the finance. It will help the company to take the correct measure if there is profitability and liquidity crises arise in the future.

Leverage is one of the factors that could affect on profitability. In common business and finance strategy, usually a company or business will make use of leverage to leverage debt in order to raise financial assets. Financial leverage commonly known as leveraging of variety of debt to increase a business' ROI.

"Highly leverage", that usually referred in company, business or investment, means the equity of the company, business or investment is lower than the debt.

Leverage can be used as the measurement of the total assets that financed with the debts. Ability of debt that used to finance the assets are from the creditors, not from the shareholders or investor who invest their capital.

Other than the leverage, *working capital* is considered as one of the aspects that could make influenced on a firm's performance. The purpose of *working capital* is to maintain the level of liquidity in a firm. With sufficient working capital, a firm could pay all of its short-term duty, has sufficient back-up to prevent from lack of stock or fund and could give credit for customer so the firm could maintain the relationship with the customers.

Liquidity could explain the quickness and readiness of an asset or security could be sold inside a market without giving influence on the asset's price. Market liquidity means the degree of the assets can be bought at normal prices in the market. Cash is considered as the most liquid asset. Asset such as real estate, fine art and collectibles are categorized as illiquid asset.

Manufacturing industry is an important key to spurring the national economy because it is more productive and provides a broad chain effect. When viewed from the side of growth in manufacturing value added (MVA), Indonesia occupies the highest position among countries in ASEAN. MVA Indonesia was able to reach 4.84 percent, while in ASEAN it was around 4.5 percent. At the global level, Indonesia is currently ranked 9th in the world. (republika.co.id)

The Ministry of Industry said the manufacturing industry would still be the main supporter of national economic growth in 2018. Data from the Ministry of Industry shows that in 2018 there are seven leading manufacturing sectors, namely

basic metals, food-beverages, transportation equipment, machinery and equipment, chemicals, pharmaceuticals, and electronics. The entire sector is also believed to bring in a huge investment. (finance.detik.com)

Manufacturing industry is one of the biggest industry in Indonesia and the biggest number of companies listed in Indonesia Stock Exchange. Out of 522 companies that listed in Indonesia Stock Exchange in 2017, there is 177 manufacturing companies listed in it which occupied the 33% from the total companies listed.

In year 2012, 128 manufacturing firms was listed in Indonesia Stock Exchange, and in 2016, its increased around 40% with around 177 manufacturing companies listed. As manufacturing firms keep on growing in Indonesia, it makes the competition between companies become more intense. The companies have to protect their position inside the market or improve their performances so they could win over the competitions among the competitors.

Based on the description above, the reason the author chose the manufacturing firms as the sample data is because manufacturing firms has the most stable increase in number within the other industry.

By using several financial ratios for manufacturing firms listed on the Indonesia Stock Exchange, it is hoped that this research will be able to explain and provide an understanding of, “**Analysis of Leverage, Working Capital, Liquidity, Cash Conversion Cycle, and Firm Size on Profitability of Manufacturing Firms Listed on Indonesia Stock Exchange**”.

1.2 Statement of Problem

With the background stated above, the main problems could be divided by:

1. Is there any impact of the financial Leverage on the profitability of the manufacturing companies listed in Indonesia Stock Exchange?
2. Is there any impact of the Working Capital on the profitability of the manufacturing companies listed in Indonesia Stock Exchange?
3. Is there any impact of the liquidity on the profitability of the manufacturing companies listed in Indonesia Stock Exchange?
4. Is there any impact of the Cash Conversion Cycle on the profitability of the manufacturing companies listed in Indonesia Stock Exchange?
5. Is there any impact of the Firm Size on the profitability of the manufacturing companies listed in Indonesia Stock Exchange?

1.3 Purposes of Study

1. To study the impact of the financial leverage on the profitability of the manufacturing companies in Indonesia Stock Exchange.
2. To study the impact of the working capital on the profitability of the manufacturing companies in Indonesia Stock Exchange.
3. To study the impact of the liquidity on the profitability of the manufacturing companies in Indonesia Stock Exchange.
4. To study the impact of the Cash Conversion Cycle on the profitability of the manufacturing companies in Indonesia Stock Exchange.

5. To study the impact of the Firm Size on the profitability of the manufacturing companies in Indonesia Stock Exchange.

1.4 Benefits of Research

Some benefits of researching topic of “Analysis of Leverage, Working Capital, Liquidity, Firm Size, and Cash Conversion Cycle on Profitability of Manufacturing Firms Listed in Indonesia Stock Exchange” are as below:

- Benefits for Academics

It is expected this study will be able to add literature or referrals that are able to expand the theory and research on the effect of the variable *Debt to Equity Ratio, Working Capital Ratio, Current Ratio, Cash Conversion Cycle and Firm Size* on *Return on Equity* at companies from manufacturing industry listed in IDX.

- Benefits for Companies

This research is expected to increase shareholder confidence in the company. The company should be able to display a good performance and able to deliver information to investors regarding the development of the company.

- Benefits for Investor

It is expected that the results of this study can be used as material for consideration of investors in choosing and investing on the Indonesia Stock Exchange so as to provide benefits and minimize the risk of loss.

1.5 Systematic Discussion

Systematic discussion aims to give general description regarding the content and discussion from each chapter in this thesis.

CHAPTER I : INTRODUCTION

The outlines of this chapter are background to the study, statement to the problem, objectives and purposes of the study and the systematic discussion of this thesis.

CHAPTER II: THEORETICAL FRAMEWORK AND FORMULATION OF HYPOTHESES

This chapter provides a systematic description of past research models, corporate financial performance, the influence of independent variables to dependent variables, the institutionalized model of research and the formulation of hypotheses.

CHAPTER III: RESEARCH METHOD

From this chapter, author describes the design and object of research, the operational definition of the variables to be tested in this study, the necessary data collection techniques as well as the method of data analysis.

CHAPTER IV: ANALYSIS AND DISCUSSION

In this chapter, the outputs from analysis was shown and also provided an explanation of the results of the hypothesis that has been tested.

CHAPTER V: CONCLUSIONS, LIMITATIONS AND RECOMMENDATIONS

This chapter contains of conclusions obtained by author on the results of hypothesis tests based on the data processing that has been done, limitations in research, and suggestions for future researchers.